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Message Text

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ACTION STR-07

INFO OCT-01 ARA-10 ISO-00 STRE-00 AGRE-00 CEA-01
CIAE-00 COME-00 DODE-00 EB-08 FRB-03 H-01 INR-10
INT-05 L-03 LAB-04 NSAE-00 PA-01 CTME-00 AID-05
SS-15 ITC-01 TRSE-00 SP-02 SOE-02 OMB-01 DOE-15
NSCE-00 SSO-00 ICAE-00 INRE-00 IO-13 EA-10 EUR-12
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O 081215Z JUN 78
FM AMEMBASSY BRASILIA
TO SECSTATE WASHDC IMMEDIATE 7807
INFO AMCONSUL RIO DE JANEIRO
AMCONSUL SAO PAULO

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PASS TREASURY FOR RESENBLOOM

EO 11652: N/A
TAGS: ETRD, BR
SUBJ: MINISTRY OF FINANCE COMMENTS ON BRAZILIAN TAX TREATIES

REFS: A) STATE 136980 B) BRASILIA 4479

1. SUMMARY - FINANCE MINISTRY GENERAL COUNSEL FRANCISCO DORNELLES MAY WISH TO MEET INFORMALLY WITH TREASURY'S INTERNATIONAL TAX COUNSEL IN NEAR FUTURE IF A MEETING CAN BE ARRANGED IN CONJUNCTIONS WITH TRIP TO WASHINGTON FOR TALKS ON EXPORT SUBSIDIES AND COUNTERVAIL-

ING DUTIES. THE FOLLOWING PROVIDES SUMMARY OF RECENT PUBLIC COMMENTS BY DORNELLES ON BRAZIL'S BILATERAL TAX TREATIES AND OBSTACLES TO CONCLUSION OF A TREATY WITH THE U.S. END SUMMARY.

2. IN EARLY MAY FRANCISCO DORNELLES,GENERAL COUNSEL OF THE MINISTRY OF FINANCE AND PRESIDENT OF THE COMMISSION FOR INTERNATIONAL
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TAX STUDIES WITHIN THE MINISTRY, GAVE AN ADDRESS ENTITLED QUOTE ASPECTS OF TAXATION OF FOREIGN CAPITAL, ESCAPE CLAUSE AND COUNTERVAILING DUTY CODES END QUOTE TO THE BRAZILIAN INSTITUTE OF FINANCIAL EXECUTIVES IN RIO. THE HIGHLIGHTS OF THE COMMENTS ON TAXES MAY BE OF INTEREST IN VIEW OF DORNELLES'DESIRE TO INFORMALLY MEET WITH TREASURY INTERNATIONAL TAX COUNSEL ROSENBLOOM DURING HIS VISIT TO WASHINGTON FOR TALKS WITH TREASURY

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AND STR ON EXPORT SUBSIDIES AND COUNTERVAILING DUTIES ON JUNE
12-13 (REF A). DORNELLES COMMENTS ON THE LATTER SUBJECT WERE
REPORTED IN REFTEL B.

3. DORNELLES FIRST LISTED EIGHT GENERAL LEGAL PRINCIPLES THAT
APPLY TO THE TAXATION OF FOREIGN CAPTIAL IN BRAZIL:
A. FOREIGN CAPTIAL RECEIVES JURIDICIAL TREATMENT IDENTICAL
TO THAT APPLIED TO NATIONAL CAPITAL AND THERE ARE NO LEGISLATIVE
RESTRICTIONS ON THE FREE ENTRY OF FOREIGN CAPTIAL;
B. FOREIGN CAPITAL INFLOWS MUST BE REGISTERED WITH THE
CENTRAL BANK AND, IN THE CASE OF TECHNICAL SERVICES, PATENTS
AND TRADEMARKS, ALSO WITH THE NATIONAL INSTITUTE OF INDUSTRIAL
PROPERTY;
C. REGISTRATION IS IN FOREIGN CURRENCY THAT ACTUALLY ENTERS
THE COUNTRY AND REINVESTED PROFITS ARE REGISTERED SIMULTANEOUSLY
IN NATIONAL CURRENCY AND THE FOREIGN CURRENCY OF THE COUNTRY
TO WHICH THERE MAY BE REMITTANCES OF EARNINGS;
D. REINVESTMENTS ARE CONSIDERED TO CONSIST OF PROFITS OF
FIRMS ESTABLISHED IN BRAZIL AND ATTRIBUTED TO FOREIGN RESIDENTS
AND THAT ARE REAPPLIED IN THE SAME FIRMS OR OTHER SECTORS
OF THE BRAZILIAN ECONOMY;
E. LOANS AND CREDITS ARE REMUNERATED WITH INTEREST RATES
PREVAILING IN THE INTERNATIONAL MARKET;
F. REMUNERATION DERIVING FROM THE PROVISION OF TECHNICAL
ASSISTANCE AND THE USE OF PATENTS AND PRODUCTION PROCESSES
AND FORMULAS VARIES BETWEEN 1 AND 5 PERCENT OF THE VALUE OF THE
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GROSS RECEIPTS FROM THE PRODUCTS TO WHICH THE CONTRACTS REFER -
IN THE CASE OF TRADEMARKS, THE REMUNERATION WILL NOT EXCEED 1
PERCENT;
G. THE REMUNERATION DERIVED FROM TECHNICAL ASSISTANCE
PAID FOR BY BRAZILIAN FIRMS, TO PHYSICAL OR JURIDICIAL PERSONS
RESIDENT OR DOMICILLED OUTSIDE BRAZIL WHO CONTROL MORE THAN
50 PERCENT OF THE CAPITAL WITH VOTING RIGHTS OF THE BRAZILIAN
FIRM, CANNOT BE DEDUCTED FOR TAX PURPOSES;
H. THERE IS NO LIMIT ON PROFIT REMITTANCES BUT THERE IS
A HEAVY SUPPLEMENTARY INCOME TAX ON REMITTANCES WHEN THE AVERAGE
OVER A THREE-YEAR PERIOD EXCEEDS 12 PERCENT OF INVESTMENTS
AND REINVESTMENTS. THE 12 PERCENT IS NET OF THE 25 PERCENT WITH-
HOLDING TAX AT THE SOURCE, WHICH CORRESPONDS THEREFORE TO
16 PERCENT GROSS.

4. DORNELLES STARTED THAT BRAZIL CURRENTLY HAS BILATERAL TAX
TREATIES WITH JAPAN, GERMANY, FRANCE,

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BELGIUM, PORTUGAL, SPAIN, SWEDEN, NORWAY, DENMARK, FINLAND,
AND AUSTRIA. HE COMMENTED BRIEFLY ON AGREEMENTS WITH THREE OTHER
COUNTRIES THAT WERE RECENTLY NEGOTIATED. TREATIES WITH ITALY
AND LUXEMBURG ARE EXPECTED TO GO INTO EFFECT IN JANUARY
1079. THE AGREEMENT WITH CANADA STILL REQUIRES SOME FURTHER
EXAMINATION OF QUOTE SOME FORMAL ASPECTS END QUOTE.
A. DORNELLES SAID THAT LUXEMBURG HAS AGREED TO EXEMPT FROM
INCOME TAX DIVIDENDS RECEIVED FROM BRAZIL BY A
COMPANY RESIDENT IN LUXEMBURG WHICH ACCOUNTS FOR AT LEAST
25 PERCENT OF THE BRAZILIAN COMPANY THAT PAYS THE DIVIDENDS.
ALSOEXEMPTEDFROM INCOME TAX IN LUXEMBURG ARE INTEREST EARNINGS
ON PUBLIC DEBT AND LOAN OBLIGATIONS PAID BY THE GOVERNMENT OF
BRAZIL TO RESIDENTS IN LUXEMBURG. LUXEMBURG WILL GRANT
A TAX CREDIT OF 20 PERCENT ON OTHER INTEREST REMITTANCES.
ON DIVIDENDS (WHERE THE CAPITAL PARTICIPATION IS LESS THAN
25 PERCENT), ROYALTIES, AND EARNINGS FROM TECHNICAL SERVICES,
THE CREDIT WILL BE 25 PERCENT AND THUS HIGHER THAN THE TAX TO
BE PAID IN BRAZIL WHICH, ACCORDING TO THE AGREEMENT, WILL BE
LIMITED TO 15 PERCENT.
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B. CANADA AGREED TO GRANT INCOME TAX EXEMPTION TO DIVIDENDS
DERIVING FROM BUSINESS ACTIVITIES WHEN THE CANADIAN
PARTICIPATION IN THE BRAZILIAN FIRM EXCEEDS 10 PERCENT OF TOTAL
CAPITAL. DORNELLES SAID THAT AS REGARDS QUOTE OTHER

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DIVIDENDS END QUOTE CANADA WILL IN MOST CASES PROVIDE TAX
EXEMPTION IN EFFECT, BY GRANTING A TAX CREDIT THAT WILL
WILL COVER BOTH THE PERSONAL AND CORPORATE BRAZILIAN TAXES
ON THE DIVIDENTDS.
C. ITALY WILL PROVIDE THE SAME TAX EXEMPTION AS LUXEMBURG
ON DIVIDENDS AND WILL GRANT A 25 PERCENT TAX CREDIT ON INTEREST
AND ROYALTIES REMITTANCES. THE BRAZILIAN TAX IS LIMITED BY THE
AGREEMENT TO 15 PERCENT.

5. DORNELLES EXPLAINED IN HIS SPEECH THAT DESPITE MANY MEETINGS
ON AGREEMENT WITH THE U.S. HAS NOT YET BEEN POSSIBLE BECAUSE
OF THREE PRINCIPAL DIFFICULTIES.
A. FIRST, THE U.S. INCOME TAX LAW IS CHARACTERIZED BY THE
PRINCIPLE OF NATIONALITY, MEANING IT TAXES ALL U.S. NATIONALS,
WHETHER RESIDENT IN THE U.S. OR NOT, FOR ALL INCOME RECEIVED,
WHETHER FROM SOURCES WITHIN THE U.S. OR NOT. DORNELLES STATED
THAT QUOTE BRAZIL COULD NEVER ABDICATE ITS RIGHT TO TAX
WITH EXCLUSIVITY ONE OF ITS RESIDENTS FOR INCOME RECEIVED IN
THE COUNTRY AND, HAVING TAXED THAT RESIDENT, COULD NOT GRANT
A CREDIT CORRESPONDING TO THE TAX IMPOSED ON HIM BY THE U.S.
FOR THE SAME INCOME END QUOTE. B. THE SECOND DIFFICULTY IS
THAT THE U.S. CONSIDERS ANY FIRM ORGANIZED UNDER U.S. LAW
TO BE A U.S. FIRM AND THUS SUBJECT TO ANY TAX AGREEMENT, EVEN
IF THE FIRMS HEADQUARTERS AND ALL OF ITS ACTIVITIES ARE OUTSIDE
THE US. THE RESULT, ACCORDING TO DORNELLES, IS THAT FIRMS LOCATED
IN TAX HAVENS WOULD BENEFIT FROM A TAX TREATY WITH THE US.,WHICH WOULD

CAUSE PROBLEMS FOR BRAZILIAN TAX ADMINISTRATION.
C. THE THIRD DIFFICULTY IS THAT THE US WILL NOT GRANT
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TAX EXEMPTION ON DIVIDENDS REMITTED FROM BRAZIL AND WILL NOT
PROVIDE TAX SPARING RELATED TO THE REDUCED OR ELIMINATED BRAZILIAN
TAX. DORNELLES STATES THAT DESPITE THE FACT THAT UNILATERAL
US TAX CREDITS SERVE TO AVOID DOUBLE TAXATION, THE US POSITION
ON EXEMPTIONS AND TAX SPARING IS A DISINCENTIVE TO EXPANSION
TO U.S. INVESTMENT IN BRAZIL.

6. IN CONCLUDING HIS COMMENTS ON THE US DORNELLES SAID THAT
IN SPITE OF EXISTING PROBLEMS A GREAT EFFORT MAY BE MADE YET
THIS YEAR IN SEARCH OF A COMPROMISE. HIS IDEA IS TO EXAMINE
THE POSSIBILITY OF CONCLUDING AN AGREEMENT WITHOUT SPECIAL CONCESSIONS

FROM EITHER SIDE BUT WHICH WOULD CONFIRM FOR A FIXED TERM
CERTAIN PROVISIONS CURRENTLY CONTAINED IN US TAX LEGISLATION
SUCH AS THE TAX CREDIT AND TAX DEFERRAL. HE SAID THAT THE THREAT
OF ELIMINATION OF TAX DEFFERAL ALWAYS CAUSE CONSIDERABLE
UNCERTAINTY FOR THOSE WHO WISH TO UNDERTAKE DIRECT INVESTMENT
IN THE U.S. HE HOPED THE US AND BRAZIL COULD AGREE TO A COMPROMISE
TO MAINTAIN EXISTING RULES FOR AT LEAST A DEFINED MINIMUM

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PERIOD OF TIME.

7. DORNELLES ALSO COMMENTED ON BRAZILIAN OBJECTIVES IN TAX TALKS WITH MEMBERS OF LAFTA BUT NOTED THAT TO DATE BRAZIL HAS NOT CONCLUDED A TAX TREATY WITH ANY LAFTA COUNTRIES.

8. EMBASSY COMMENT. JUDGING FROM DORNELLES COMMENTS. THE GOB HAS NOT CHANGED ITS POSITION SINCE THE EXCHANGE OF VIEWS WITH DEPUTY ASSISTANT SECRETARY HUFBAUER IN FEBRUARY. THEY CONTINUE TO BE INTERESTED IN A POSSIBLE LIMITED OR PARTIAL TAX CONVENTION THAT WOULDLIMIT REFERENCE TO AREAS WHERE AGREEMENT HAS NOT BEEN POSSIBLE. ON THE OTHER HAND, THEY ALSO CONTINUE TO ENTERTAIN HOPES -- DESPITE COMMENTS TO THE CONTRARY TO THEM BY HUFBAUER AND SUBSEQUENTLY BY FINATT -- THAT THEY MAY BE ABLE TO ASSURE CONTINUED TAX DEFERRAL IN ITS PRESENT FORM REGARDLESS OF POSSIBLE CONGRESSIONAL ACTIONS. DORNELLES CLEARLY WOULD LIKE TO ADD THE US TO HIS LIST OF BILATERAL TREATIES BUT IT DOES NOT APPEAR
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THAT THE GOB IS PREPARED TO ALTER ITS POSITIONS SUFFICIENTLY TO ACCOMMODATE OUR REQUIREMENTS.
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TAGS: ETRD, OVIP, BR, US, (DORNELLES, FRANCISCO)
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Type: TE
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